Back to the futures

Because of the speculative nature of futures, many investors may be wary of them. But in reality, when used prudently, these financial instruments may be able to help you diversify your portfolio and potentially lessen the impact of losses in volatile markets – all without you having to own the underlying asset.

Commodity futures are contracts traded on a regulated exchange known as the futures market.

How do futures work?

To get an idea of how futures work, you may want to think of them as an IOU for tangible items, such as commodities (corn, wheat, rice, oats); energies (oil, gasoline, natural gas); metals (aluminum, gold, copper) as well as equity indexes, global bonds and currencies. These IOUs allow investors to gain access to the tangible items either through forward contracts, where they accept or make a delivery of a commodity or asset at a future date for a price that's contracted today, or through a commodity futures contract. Commodities futures and forward contracts are generally volatile and may be subject to risk not associated with traditional investments and may not be suitable for all investors.

Futures are standardized contracts between two parties to purchase or sell financial instruments or physical commodities for future delivery on a regulated commodity futures exchange.

A **forward contract** is a customized contract between two parties to buy or sell an asset at a specified price on a future date.

What does a commodity futures contract look like?

Contract price

An investor buys a contract for 10 barrels of oil at $75 a barrel.

Market price

Six months later, the price of oil is $90 per barrel.

Investor profit

The investor then sells his contract for a profit.

Hypothetical example is for illustrative purposes only and is not a recommendation to buy/sell any securities. These are not actual holdings. If the price of oil were to go down rather than to go up, the investor would lose money rather than profit.

All futures contracts have a buyer and a seller in order to complete the transaction. The buyer and the seller may have different goals, but both are looking to protect themselves from an undesired outcome.

Who uses futures?

Hedgers are generally producers and consumers. Producers are concerned about falling prices while consumers are concerned about rising prices. Producers will use futures to hedge against falling prices and consumers will use futures to hedge against rising prices.

Speculators are generally traders that will use futures to make directional investments. They use futures to invest or speculate on the direction of the market.

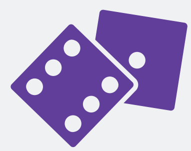
Mutual fund managers may use financial futures to gain exposure to the markets on a long or short basis. They also use futures to hedge existing positions in their portfolio as well as to speculate across global markets beyond traditional equities and fixed income.

The commodities futures market is closely regulated by the US government and self-regulatory organizations within the industry.

Hedgers, speculators and investors may use futures for a variety of reasons

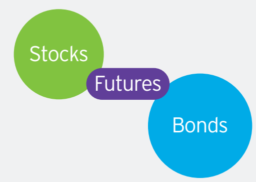
Hedgers may use futures to:

- Achieve price certainty
- Offset risk
- Producers use futures to hedge against falling prices and consumers to hedge against rising prices



Speculators may use futures to:

- Speculate on the direction of different markets
- Short if they feel prices are going to fall
- Speculate long if they believe the price of the investment is going to rise



Mutual funds may use futures to:

- Diversify or complement a traditional portfolio
- Seek to capture profits in both rising and falling markets
- Gain exposure to alternative markets
- Reduce risk by hedging

For illustrative purposes only

Talk to your financial professional

Mutual fund portfolio managers might use futures to hedge or speculate, which is why it's so important for the average investor to understand the language used in futures buying. Talk to your financial professional, who can further explain future contracts' risks and rewards.

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